

## Minnesota Enacts Omnibus Tax Bill with Changes to Corporate Income Tax Provisions, Personal Income Tax Rate and Sales and Use Tax

May 24, 2013

### Overview

On May 23, 2013, Minnesota Governor Mark Dayton signed House Bill 677 ("H.F. 677").<sup>1</sup> The bill amends Minnesota tax law in the following manner:

- Eliminates certain corporate income tax subtraction modifications, adopts a *Finnigan* sales factor sourcing rule and modifies the utilization of the Research and Development Credit.
- Creates a new 4<sup>th</sup> tier individual income tax bracket for high income earners and increases the alternative minimum tax rate.
- Repeals the provisions of Minnesota tax law incorporating the Multistate Tax Compact.
- Expands the sales tax base to include certain services, expands the definition of nexus and provides an up-front exemption for purchases of capital equipment.

Many of these tax changes were proposed in Governor Dayton's budget released on February 22, 2013<sup>2</sup> and revised on March 14, 2013.<sup>3</sup> In this Tax Alert, we highlight the more significant tax law changes<sup>4</sup> to the corporate income tax, individual income tax and sales and use tax.

### Corporate Income Tax

Effective for taxable years beginning after December 31, 2012, H.F. 677 makes the following amendments to the corporate income tax:

- The dividend received deduction for dividends paid by a Real Estate Investment Trust to a corporation is eliminated.<sup>5</sup>
- The foreign royalty subtraction is eliminated.<sup>6</sup> Under prior law, taxpayers were allowed to subtract 80 percent of certain royalties, fees and other income received from foreign corporations that were part of the same unitary business.<sup>7</sup>
- The income and apportionment provisions relating to foreign operating corporations are eliminated.<sup>8</sup> Under prior law, companies that qualified as a foreign operating corporation ("FOC") were excluded from the Minnesota unitary filing group. The FOC's income was then added back to the unitary group's net income through a deemed dividend with the unitary group subsequently

<sup>1</sup> Chapter 143, H.F. No. 677, 2013 Regular Session, available at [https://www.revisor.leg.state.mn.us/bills/text.php?number=HF677&session\\_year=2013&session\\_number=0&version=latest](https://www.revisor.leg.state.mn.us/bills/text.php?number=HF677&session_year=2013&session_number=0&version=latest)

<sup>2</sup> *Budget for a Better Minnesota*: Governor Mark Dayton's FY 2014-15 Budget Recommendations, available at: <http://www.mmb.state.mn.us/doc/budget/bud-op/op14/gov-presentation.pdf>

<sup>3</sup> *Budget for a Better Minnesota*: Governor Mark Dayton's FY2014-15 Supplemental Budget, available at: <http://www.mmb.state.mn.us/march14-13>

<sup>4</sup> While not addressed in detail in this Alert, the new law also imposes a gift tax. Effective for taxable gifts made after June 30, 2013, a 10% tax is imposed on the transfer of property by gift by any individual resident or nonresident. A credit is allowed against the tax imposed equal to \$100,000 which applies to the cumulative amount of taxable gifts made by the donor during the donor's life time. Minnesota Statutes 2013, section 292.17 as added by H.F. 677, 140.7.

<sup>5</sup> Minnesota Statutes 2013, section 290.21, subdivision 4(c), amended by H.F. 677, 129.28.

<sup>6</sup> Minnesota Statutes 2013, section 290.01, subdivision 19d, amended by H.F. 677, 107.22.

<sup>7</sup> Minnesota Statutes 2012, section 290.01, subdivision 19d(10).

<sup>8</sup> Minnesota Statutes 2013, section 290.01, subdivisions 19c(11), (20), (21), (22), (23) and section 290.17, subdivision 4(g) amended by H.F. 677, 103.21, 104.15, 105.1, 105.18, 105.23 and 124.11.

receiving an 80% dividend received deduction.<sup>9</sup> As a result of the law changes enacted by H.F. 677, the FOC characterization is no longer relevant.

- The income of a foreign entity, other than an entity treated as a C corporation for federal income tax purposes, that is included in the federal taxable income of a domestic corporation, domestic entity, or individual must be included in determining the net income of a unitary business.<sup>10</sup> In this situation, a proportionate share of the apportionment factors of the foreign entity will also be included in the apportionment factor of the unitary business. Under prior law, the income and apportionment factors of any foreign entity were excluded from the Minnesota unitary return.<sup>11</sup>
- All sales sourced to Minnesota of a unitary business are now included in the sales factor numerator regardless of whether the specific unitary member making the sale has nexus in Minnesota (i.e., *Finnigan* apportionment approach).<sup>12</sup> Under prior law, only Minnesota-sourced sales of a unitary member having nexus with Minnesota were included in the numerator of the Minnesota sales factor (i.e. *Joyce* apportionment approach).<sup>13</sup>
- The previously refundable Research and Development Credit is now nonrefundable. However, any excess credit must be applied against the tax of another unitary group member with a liability.<sup>14</sup> Any excess credit is carried forward to each of the 15 succeeding taxable years.<sup>15</sup>

## Multistate Tax Compact

H.F. 677 repeals Minnesota Statutes 2012, section 290.171, the remaining element of the Multistate Tax Compact previously contained in Minnesota tax law.<sup>16</sup> However, H.F. 677 adds statutory authority authorizing the Minnesota Department of Revenue to participate in audits performed by the Multistate Tax Commission.<sup>17</sup>

## Personal Income Tax

Effective for taxable years beginning after December 31, 2012, H.F. 677 creates a new 4<sup>th</sup> tier income tax bracket at a marginal rate of 9.85% (current top rate is 7.85%) and increases the alternative minimum tax rate to 6.75% (current rate is 6.4%).<sup>18</sup>

## Sales and Use Tax

Effective for sales made after June 30, 2013, the definition of taxable sales and purchases are expanded to include the following:

- Specified digital products. These include digital audio works, digital audiovisual works and digital books that are transferred electronically or on tangible medium.<sup>19</sup>

---

<sup>9</sup> Minnesota Statutes 2012, section 290.01, subdivision 19c (11).

<sup>10</sup> Minnesota Statutes 2013, section 290.17, subdivision 4(f), amended by H.F. 677, 123.33; section 290.17, subdivision 4(g), amended by H.F. 677, 124.35.

<sup>11</sup> Minnesota Statutes 2012, section 290.17, subdivision 4(f). Generally speaking, the income and apportionment factors of foreign flow-through entities will be impacted by this law change.

<sup>12</sup> Minnesota Statutes 2013, section 290.17, subdivision 4(h), amended by H.F. 677, 125.16.

<sup>13</sup> Minnesota Statutes 2012, section 290.17, subdivision 4(j)

<sup>14</sup> Minnesota Statutes 2013, section 290.068, subdivision 6a, amended by H.F. 677, 113.9; section 290.068, subdivision 3, amended by H.F. 677, 112.22.

<sup>15</sup> Minnesota Statutes 2012, section 290.68, subdivision 3(b)

<sup>16</sup> Minnesota Statutes 2013, section 290.171, amended by H.F. 677, 277.16. As a result of the enactment of H.F. 677, it would appear that Minnesota no longer is a full member of the Multistate Tax Compact. Since no enactment date was specified in the bill, the repeal of the Multistate Tax Compact will be effective August 1, 2013 per Minnesota Statute 645.02.

<sup>17</sup> Minnesota Statutes 2013, section 270C.03, subdivision 1(9), amended by H.F. 677, 266.15.

<sup>18</sup> Minnesota Statutes 2013, section 290.091, subdivision 1 and section 290.06, subdivision 2c(a)-(c), amended by H.F. 677, 116.9 and 109.2. The marginal rate of 9.85% applies to taxpayers with Minnesota taxable income above \$250,000 for married filing joint, \$125,000 for married filing separate, \$150,000 for single filers and \$200,000 for head-of-household filers.

<sup>19</sup> Minnesota Statutes 2013, section 297A.61, subdivision 3(l), amended by H.F. 677, 149.25.

- Repair and maintenance of electronic and precision equipment such as computers, monitors, photocopying machines, printers, televisions and stereo systems if deducted as a business expense under the Internal Revenue Code.<sup>20</sup>
- Repair and maintenance of commercial and industrial machinery and equipment.<sup>21</sup>

Effective for sales and purchases made after March 31, 2014, the definition of taxable sales and purchases are expanded to include warehousing or storage services for tangible personal property. Sales tax will not be levied upon the warehousing or storage of agricultural products, refrigerated storage, electronic data and self-storage of motor vehicles, recreational vehicles, and boats not deductible as a business expense under the Internal Revenue Code.<sup>22</sup>

Effective for sales and purchases made after August 31, 2014, capital equipment (machinery and equipment used in manufacturing) will now be exempt from sales and use tax at the time of purchase.<sup>23</sup> Previously, manufacturers were required to pay tax on capital equipment and request a refund of the tax.<sup>24</sup>

Effective for sales and purchases made after June 30, 2013, the new law provides relief to purchasers who do not have a direct pay permit for purchases of digital goods, computer software delivered electronically, or services in which the goods or services will be available for use in more than one taxing jurisdiction. In those cases, the purchaser may provide the seller with a multiple points of use exemption certificate.<sup>25</sup> This will allow companies to use a reasonable method of apportionment to allocate a portion of the price to other taxing jurisdictions for purposes of calculating and remitting Minnesota use tax.<sup>26</sup>

Effective for sales and purchases made after June 30, 2013, remote sellers that enter into an agreement with a resident of Minnesota whereby the resident receives a commission or other consideration to direct potential customers to the seller will be presumed to have Minnesota nexus for sales and use tax purposes unless rebutted by proof that the resident did not engage in any solicitation in the state on behalf of the retailer.<sup>27</sup>

## Contacts

If you have questions regarding the new tax legislation or other Minnesota tax matters, please contact any of the following Deloitte Tax professionals.

Mark Faulkner  
Director  
Deloitte Tax LLP, Minneapolis  
[mfaulkner@deloitte.com](mailto:mfaulkner@deloitte.com)  
(612) 692-7195

Raymond Goertz  
Senior Manager  
Deloitte Tax LLP, Minneapolis  
[rgoertz@deloitte.com](mailto:rgoertz@deloitte.com)  
(612) 659-2768

Joseph Wessbecker  
Manager  
Deloitte Tax LLP, Minneapolis  
[jwessbecker@deloitte.com](mailto:jwessbecker@deloitte.com)  
(612) 397-4471

<sup>20</sup> Minnesota Statutes 2013, section 297A.61, subdivision 3(m)(1), amended by H.F. 677, 149.34. It appears that consumers would not be subject to this change.

<sup>21</sup> Minnesota Statutes 2013, section 297A.61, subdivision 3(m)(2), amended by H.F. 677, 150.6.

<sup>22</sup> Minnesota Statutes 2013, section 297A.61, subdivision 3(m)(3), amended by H.F. 677, 150.10.

<sup>23</sup> Minnesota Statutes 2013, section 297A.68, subdivision 5(a), amended by H.F. 677, 167.18.

<sup>24</sup> Minnesota Statutes 2012, section 297A.68, subdivision 5(a).

<sup>25</sup> Minnesota Statutes 2013, section 297A.668, subdivision 6(a), amended by H.F. 677, 162.20, A direct pay permit allows a purchaser to procure taxable goods and services without remitting sales tax to the seller. If the purchaser has a direct pay permit, it would continue to provide the permit to retailers allowing the purchaser to apportion or allocate a portion of the price to other taxing jurisdictions for purposes of calculating and remitting Minnesota use tax.

<sup>26</sup> Minnesota Statutes 2013, section 297A.668, subdivision 6(a)(2)(c), amended by H.F. 677, 162.32.

<sup>27</sup> Minnesota Statutes 2013, section 297A.66, subdivision 4(b), amended by H.F. 677, 160.26. The solicitation must satisfy the nexus requirement of the United States Constitution during the 12-month period ending on the last day of the most recent calendar quarter before the calendar quarter in which the sale is made.

**This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.**

**About Deloitte**

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2013 Deloitte Development LLC. All rights reserved.  
Member of Deloitte Touche Tohmatsu Limited